STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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June 20, 2014

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1603, *Taxable Sales of Food Products*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*. The proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. Instead, the proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The proposed amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions occurring on and after January 1, 2015. In addition, the proposed amendments make non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to other regulations following the authority and reference note.

PUBLIC HEARING

The Board will conduct a meeting in Room 207 at its offices at 5901 Green Valley Circle, Culver City, California on August 5-7, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on August 5, 6, or 7, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1603.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374, and 6376.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers' gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board's Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-

references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulations authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to

customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants' and similar establishments' collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1603 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1603 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Cary Huxsoll, Tax Counsel III, by telephone at (916) 323-3092, by e-mail at Cary.Huxsoll@boe.ca.gov, or by mail at State Board of Equalization, Attn: Cary Huxsoll, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on August 5, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1603 during the August 5-7, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1603. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1603 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1603, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1603 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1603, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the August 5, 2014 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Initial Statement of Reasons for

Proposed Amendments to California Code of Regulations,

Title 18, Section 1603, *Taxable Sales of Food Products*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax. Code, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (Rev. & Tax. Code, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (Rev. & Tax. Code, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, as relevant here, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (Rev. & Tax. Code, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to taxable sales of food products are includible in retailers' gross receipts.

In addition, Labor Code section 351 provides that no employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of a gratuity, or require an employee to credit the amount, or any part thereof, of a gratuity against and as a part of the wages due the employee from the employer. And, this prohibition applies to employers who operate restaurants and similar establishments whose employees receive gratuities from their customers.

California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, provides guidance to restaurants, hotels, boarding houses, soda fountains, and similar establishments that make taxable sales of food products. Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

Specifically, Regulation 1603, subdivision (g)(1)(A), provides that "[a] payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services," and provides examples illustrating when the payment of an amount designated as a tip, gratuity, or service charge is optional. Also, Regulation 1603, subdivision (g)(1)(B) incorporates the prohibition in Labor Code section 351, and provides that when the "prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax."

Regulation 1603, subdivision (g)(2)(A), provides that "[a]n amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory." Regulation 1603, subdivision (g)(2)(B), provides that "[w]hen the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax," and provides examples of such printed statements. Regulation 1603, subdivison (g)(2)(B) provides that "[a]n amount will be considered 'automatically added' when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip." Also, Regulation 1603, subdivision (g)(2)(B), provides that "any amount added [to the bill] by the retailer is presumed to be mandatory," and Regulation 1603, subdivision (g)(2)(C), prescribes the type of evidence that must be provided to controvert (or rebut) the presumption and provides examples of such evidence.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the four following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Proposed Amendments

Interested Parties Process

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to State Board of Equalization (Board) staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. As a result, the Board's Business Taxes Committee (BTC) staff prepared

draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues (or problems within the meaning of Gov. Code, § 11346.2, subdivision (b)) by establishing a new bright-line approach for determining whether payments (or amounts) designated as tips, gratuities, and service charges are "optional" or "mandatory" based upon how the retailer treated the amounts for Internal Revenue Service purposes. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion for retailers and staff.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013 to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the new presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. (See Exhibits 3 and 4 to Formal Issue Paper 2014-003 referred to below.) In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and stated that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g) (discussed above). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of

meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout Regulation 1603, subdivision (g). Additionally, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. (See Exhibit 5 to Formal Issue Paper 2014-003 referred to below.) In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, without any changes, and new subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's current cross-references to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g), including subdivision (g)'s record keeping requirements and provisions regarding violations of the prohibition in Labor Code section 351. The formal issue paper also recommended making non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to

other regulations following the authority and reference note. (See Exhibit 2 to Formal Issue Paper 14-003.)

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are reasonably necessary to have the effect and accomplish the specific purpose of addressing the retailers' compliance issues (discussed above) due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges.

The Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting, and thereby reduce confusion for retailers and staff.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1603 or the proposed amendments to Regulation 1603.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-003, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its May 22, 2014, BTC meeting in deciding to propose the amendments to Regulation 1603 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1603 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, the proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. The proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions on or after January 1, 2015.

Specifically, new subdivision (h) defines "amount" as a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. New subdivision (h)(1) provides that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply. And, new subdivision (h)(1) provides examples of transactions where amounts are optional and not subject to tax, which are consistent with the current examples in Regulation 1603, subdivision (g)(1)(A).

Also as previously explained, new subdivision (h)(2) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. New subdivision (h)(3) prescribes the application of tax when the examples of amounts that are optional in subdivision (h)(1) do not apply and a retailer does not maintain records for purposes of reporting the amounts to the Internal Revenue Service, and new subdivision (h)(3) is consistent with the current provisions of Regulation 1603, subdivision (g)(2). New subdivision (h)(3) provides that when an amount is negotiated between the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks, the amount is mandatory. When the menu or other printed materials notify customers that amounts will or may be added by the retailer to the bill, and such amounts are automatically added by the retailer to the bill, the amount is a mandatory charge and subject to tax. It is presumed that an amount added by the retailer to the bill is automatically added and mandatory; however, this presumption may be overcome by documentary evidence showing that the customer specifically requested and authorized the amount to be added to the bill.

Also, as previously explained, the proposed amendments are intended to address retailers' compliance issues due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. There is nothing in the proposed amendments to Regulation 1603 that would significantly change how restaurants and similar establishments would generally behave in the absence of the proposed amendments. And, the

Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by addressing and reducing such confusion.

In addition, the amendments to Regulation 1603 do not impose any costs on any persons, including restaurant businesses, because the proposed amendments do not impose new record keeping requirements and take into account, rather than impact, current practices in the restaurant industry regarding tips, gratuities, and service charges. And, the proposed amendments do not impact revenue. (See Exhibit 1 to Formal Issue Paper 14-003.) Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. And, the Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars ($50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1603 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1603 may affect small businesses.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1603

1603. Taxable Sales of Food Products.

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term "boarding house" as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a "guest home," "residential care home," "halfway house," and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term "American Plan Hotel" as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term "complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests' bills, and

2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term "average retail value of complimentary food and beverages" (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term "average daily rate" (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. "Gross room revenue" means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from

contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented on a nightly basis provided the revenue for those rooms is included in the "gross room revenue.". For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan Hhotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (hi) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (Ssee subdivision (hi)(3)(C)2.)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be

considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA: ARV ÷ ADR ≤ = 10%

Average Daily Rate (ADR):

Room Revenue	$9,108,000
Rooms Rented	74,607
ADR ($9,108,000 ÷ 74,607)	$122.08

Average Retail Value of Complimentary Food and Beverages (ARV):

Complimentary Food Cost	$169,057
Complimentary Beverage Cost	52,513
Total	$221,570
Add 100% Markup	221,570
Average Retail Value	$443,140
ARV per occupied room ($443,140 ÷ 74,607)	$5.94

Application of Formula: $5.94 ÷ $122.08 = 4.87%

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as "incidental." The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location's complimentary food and beverages qualify as incidental.

(C) "Free" Meals. When a restaurant agrees to furnish a "free" meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) "Drive-Ins." Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the "drive-in" establishment, even though such products are sold on a "take out" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer's premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer's premises, without eating utensils, trays, or dishes and not consumed on the retailer's premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.[1]

(c) Cold Food Sold on a "Take-Out" Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller's premises even though such food

products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and

2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

(A) More than 80 percent of the seller's gross receipts are from the sale of food products, and

(B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) Definitions.

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.

2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.

3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place.

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (~~p~~q) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc.. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger's seat aboard a train, or a spectator's seat at a game, show, or similar event is not a "chair" within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not "for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer."

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.

(1) Optional Payment.

(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in an amount:

Guest Check~~Guest Check~~	
Food Item A	$9.95
Beverage Item B	3.75
Subtotal	$13.70
8% sales tax	1.10
Subtotal	$14.80
Tip*	
Total	

*Suggested tips:
15%=$2.06; 18%=$2.47; 20%=$2.74; other.

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.

2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.

3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)
The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, "amount" means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in the amount:

Guest Check	
Food Item A	$9.95
Beverage Item B	3.75
Subtotal	$13.70
8% sales tax	1.10
Subtotal	$14.80
Tip*	
Total	

*Suggested tips:
15%=$2.06; 18%=$2.47; 20%=$2.74; other.

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer's taxable gross receipts.

(2) Mandatory Payment.

When a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that the amount "may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without "tip" or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.

2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.

3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records.*

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(~~h~~i) Caterers.

(1) Definition. The term "caterer" as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer's employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of

providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (ij) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (ij) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income

taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(~~i~~j) Social Clubs and Fraternal Organizations. "Social Clubs and Fraternal Organizations" as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

(~~j~~k) Student Meals.

(1) Definitions.

(A) "Food Products."~~:~~ As used herein, the term "food products" as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) "Meals."~~:~~ As used herein, the term "meals" includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term "meals" does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a "nutrition break", "recess", or similar break, will not be considered "meals."~~:~~

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does

apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (~~h~~i) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;

2. The fixtures and equipment used by the caterer are owned and maintained by the school; and

3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

(~~k~~l) Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

(A) Employee pays cash for meals consumed.

(B) Value of meals is deducted from employee's wages.

(C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.

(D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the nonfood~~non-food~~ products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under (l)(2)~~(k) (2)~~ a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is $46.00, and the employee received $43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of $2.10, the employer has received gross receipts in the amount of $2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

(~~l~~m) Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

(~~m~~n) Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

(~~n~~o) Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

(~~o~~p) Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

(~~p~~q) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

(~~q~~r) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

(~~r~~s) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

(~~s~~t) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977 and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(~~t~~u) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale

takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

(~~u~~v) Mobile Food Vendors. Mobile food vendors include retailers who sell food and beverages for immediate consumption from motorized vehicles or un-motorized carts. Examples of mobile food vendors include food trucks, coffee carts, and hot dog carts. For sales made on or after July 1, 2014, unless a separate amount for tax reimbursement is added to the price, mobile food vendors' sales of taxable items are presumed to be made on a tax-included basis.

This presumption does not apply when a mobile food vendor is making sales as a "caterer" as defined in (~~h~~i)(1).

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1 The records acceptable in support of such a deduction are:

(a) A sales ticket prepared for each transaction claimed as being tax exempt showing:

(1) Date of the sale,

(2) The kind of merchandise sold,

(3) The quantity of each kind of merchandise sold,

(4) The price of each kind of merchandise sold,

(5) The total price of merchandise sold,

(6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and

(b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506.
Nonprofit organizations as consumers, see Regulation 1597.

Appendix A

California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____

(company name)

Address _____

Signed By _____

(signature of authorized person)

_____

(print or type name)

Title _____

(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code.~~

~~Food Products Generally, see Regulation 1602.~~

~~Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700.~~

~~"Free" meals with purchased meals, see Regulation 1670.~~

~~Meals served to patients and inmates of an institution, see Regulation 1503.~~

~~Vending Machines, when considered selling meals, see Regulation 1574.~~

~~Meals at summer camps, see Regulation 1506(e).~~

~~Parent-Teacher associations as consumers, see Regulation 1597.~~

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1603

Title: 1603, *Taxable Sales of Food Products*

Preparation: Cary Huxsoll
Legal Contact: Cary Huxsoll

The proposed amendments to Regulation 1603, *Taxable Sales of Food Products,* clarify the application of tax to tips, gratuities, and service charges.

History of Proposed Regulation:

August 5-7, 2014	Public Hearing
June 20, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
June 10, 2014	Notice to OAL
May 22, 2014	Business Tax Committee, Board Authorized Publication (Vote 4-0)

Sponsor:	NA
Support:	NA
Oppose:	NA